WEALTH MANAGEMENT

CORE Wealth Management

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"HELPING YOU MAKE SMART CHOICES ABOUT YOUR MONEY"

SECOND-GUESSING

Article by Jim Parker

Markets recently have had a rocky time as investors in aggregate reassess prospects for monetary policy stimulus in the US. Is this something to worry about?

The world's most closely watched central bank unsettled financial markets by flagging that it may start to scale back its bond purchases later this year.

Under this program of so-called "quantitative easing," the Fed buys $85 billion a month in bonds as a way to keep long-term borrowing costs down and help generate a self-sustaining economic recovery.

What spooked the markets was a comment by Fed Chairman Ben Bernanke on May 22 that the central bank may start to scale back those purchases in coming meetings.

The mere prospect of the monetary tap being turned down caused a reassessment of risk, leading to a retreat in developed and emerging economy equity markets, a broad-based rise in bond yields, and a decline in some commodity markets and related currencies, such as the Australian dollar.

Gold, in particular, was hit hard by the Fed's signals, with the spot bullion price falling 23% during the second quarter on the view that rising bond yields and a strengthening US dollar would hurt the metal's appeal as a perceived safe haven.

For the long-term investor, there are a few ways of looking at these developments.

First, we are seeing a classic example of how markets efficiently price in new information. Prior to Bernanke's remarks, markets might have been positioned to expect a different message than he delivered. They adjusted accordingly.

Second, since the patient is showing signs of recovery, policymakers can publicly countenance a change in policy—"taking away the punch bowl."

This is not to make any prediction about the course of the US or global economy. It just tells you that policymakers and investors are reassessing the situation.

Third, for all the people quitting positions in risky assets like stocks or corporate bonds, there are others who see long-term value in those assets at lower prices. The idea that there are more sellers than buyers is just silly.

Fourth, the rise in bond yields is a signal that the market in aggregate thinks interest rates will soon begin to rise. That is what the market has already priced in. What happens next, we don't know.

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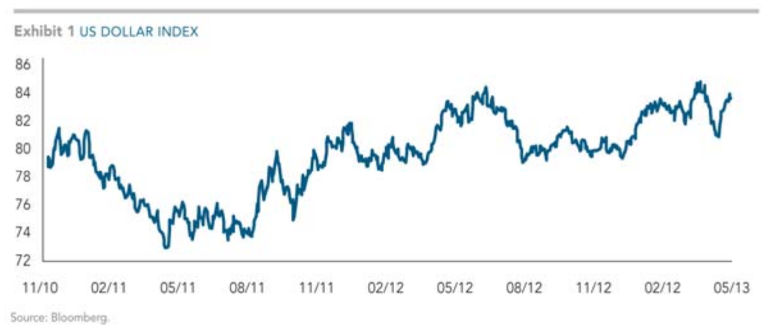

WHAT'S INSIDE

Second-Guessing (continued)

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Keep in mind that when the Federal Reserve began its second round of quantitative easing in late 2010, there were dire warnings in an open letter to the central bank from a group of 23 economists about "currency debasement and inflation."[1]

Yet, US inflation is now broadly where it was, and the US dollar is higher than when those warnings were issued (see charts on page 1), suggesting that basing an investment strategy around supposedly expert forecasts is not always a good idea.

So, it would pay to exercise skepticism with respect to predictions on the likely path of bond yields, interest rates, and currencies in the wake of the Fed's latest signals. Just because something sounds logical doesn't mean it's going to happen.

Fifth, a rise in bond yields equates to a fall in bond prices. Just as in equities, a fall in prices equates to a higher expected return. So selling bonds after prices have fallen echoes the habit some stock market investors have of buying high and selling low.

Finally, keep in mind the volatility is usually most unnerving to those who pay the most attention to the daily noise. Those who take a longer-term, distanced perspective can see these events as just part of the process of markets doing their work.

After all, the individual investor is unlikely to have any particular insights on the course of global monetary policy, bond yields, or emerging markets that have not already been considered by the market in aggregate and built into prices.

What individuals can do, with the assistance of a professional advisor, is manage their emotions and remain focused on their long-term, agreed-upon goals.

Otherwise, you risk reacting to something that others have already countenanced, priced into expectations, and moved on from as further information emerged.

Inevitably, second-guessing markets means second-guessing yourself.

1. Floyd Norris, "Predictions on Fed Strategy that Did Not Come to Pass," *New York Times*

The Art of Letting Go

Article by Jim Parker

In many areas of life, intense activity and constant monitoring of results represent the path to success. In investment, that approach gets turned on its head.

Photo cou[illegible] FreeDigitalPhotos.net

The Chinese philosophy of Taoism has a word for it: "wuwei." It literally means "non-doing." In other words, the busier we are with our long-term investments and the more we tinker, the less likely we are to get good results.

That doesn't mean, by the way, that we should do nothing whatsoever. But it does mean that the culture of "busyness" and chasing returns promoted by much of the financial services industry and media can work against our interests.

Investment is one area where constant activity and a sense of control are not well correlated. Look at the person who is forever monitoring his portfolio, who fitfully watches business TV, or who sits up at night looking for stock tips on social media.

In Taoism, by contrast, the student is taught to let go of factors over which he has no control and instead go with the flow. When you plant a tree, you choose a sunny spot with good soil and water. Apart from regular pruning, you leave the tree to grow.

But it's not just Chinese philosophy that cautions us against busyness. Financial science and experience show that our investment efforts are best directed toward areas where we can make a difference and away from things we can't control.

So we can't control movements in the market. We can't control news. We have no say over the headlines that threaten to distract us.

But each of us can control how much risk we take. We can diversify those risks across different assets, companies, sectors, and countries. We do have a say in the fees we pay. We can influence transaction costs. And we can exercise discipline when our emotional impulses threaten to blow us off-course.

These principles are so hard for people to absorb because the perception of investment promoted through financial media is geared around the short-term, the recent past, the ephemeral, the narrowly focused and the quick fix.

We are told that if we put in more effort on the external factors, that if we pay closer attention to the day-to-day noise, we will get better results.

What's more, we are programmed to focus on idiosyncratic risks—like glamor stocks—instead of systematic risks, such as the degree to which our portfolios are tilted toward the broad dimensions of risk and return.

Ultimately, we are pushed toward fads that the financial marketing industry decides are sellable, which require us to constantly tinker with our portfolios.

You see, much of the media and financial services industry wants us to be busy about the wrong things. The emphasis is often on the excitement induced by constant activity and chasing past returns, rather than on the desired end result.

The consequence of all this busyness, lack of diversification, poor timing decisions, and narrow focus is that most individual investors earn poor long-term returns. In fact, they tend to not even earn the returns available to them from a simple index.

This is borne out each year in the analysis of investor behavior by research group Dalbar. In 20 years, up to 2012, for instance,

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Going The Distance

Do you still have a long way to go to reach your retirement savings goal? Whenever you get discouraged, remind yourself that saving for retirement isn't a sprint, it's more like a marathon. And your employer's plan offers several advantages that can help you reach the finish line.

Encouraging News

After tanking during the 2008 stock market crash and the Great Recession that followed, retirement account balances have been climbing back. When the stock market hit bottom in the first quarter of 2009, retirement accounts had lost about 31% of their peak 2007 values. By the end of 2012, account balances (adjusted for inflation) were only 1% below their 2007 peak.*

Although your personal experience may be different — and it's impossible to predict what the future holds for the investment markets — the signs of recovery are encouraging news for retirement investors.

It's Not Always Easy

Still overwhelmed by the prospect of saving enough money for retirement? That's completely understandable, especially since you probably have many other demands on your money. But having a strategy can help.

To be successful, it's important not to spend more than you earn. Going into debt for things you don't need can be a slippery slope. Interest payments and other fees on credit cards and consumer loans can really add up, making it hard for you to get ahead financially. Keeping your budget in the black makes it possible to save for your financial goals, including retirement.

Being proactive about saving is a better approach than waiting until the end of a pay period to see if you have anything left to add to your savings. With so many things to spend your hard-earned money on, setting aside money for your future can take a backseat unless you make it a priority.

A Great Way To Save

Contributing to your employer's retirement plan is a simple, effective way to be proactive and pay yourself first. You don't see the money that goes into your account, so you don't miss it and you can't spend it.

Tax benefits are another good reason to save in your employer's retirement plan. The portion of your pay that you contribute to your plan on a pretax basis won't be subject to federal income tax until the money is distributed to you. So you owe less tax now. Any investment earnings on your contributions are also tax deferred. You don't have to pay income tax on the earnings your retirement plan investments generate until you withdraw them.**

A Plan for the Future

No one knows how the investment markets will perform in the future. But there will almost certainly be dips ahead. Although the past doesn't predict the future, the stock market has always recovered from past downturns. What should your strategy as a retirement investor be? Keep contributing regardless of what the markets are doing, choose investments that fit your situation, and increase the amount you're contributing as often as you can.

*Retirement Security Data Brief Number 6, *Urban Institute, January 2013*

*** Some retirement plans also offer a Roth contribution option. Unlike pretax contributions, Roth contributions do not offer immediate tax savings. However, qualified Roth distributions are not subject to federal income taxes when all requirements are met.*

One Part of the Picture

Are you counting on Social Security to provide most of your retirement income? If your answer is "yes," then you should take a closer look at the numbers.

By the Numbers

While you don't know the exact amount of your future Social Security benefit, you can assume it will be much less than the income you'll require to maintain your standard of living. You can get an estimate of your future retirement benefit by reviewing your personal Social Security Statement online at *www.ssa.gov*.

Your actual Social Security benefit will depend on your earnings record and when you retire. At the end of 2012, the average monthly Social Security benefit retired workers received was $1,262 — or $15,144 a year.* Compare that to your current income. If the difference between the two figures is significant, one good way to help close the gap is to save more in your retirement plan account.

Add It Up

When you stop working, you may have a number of sources of retirement income. Among current retirees, income comes from Social Security benefits (37% of total income), working during retirement (30%), pensions (18%), savings (11%), and other sources (4%).** It's a good idea to plan on having several sources of income rather than relying on just one source.

Your Solution

Your employer's retirement plan gives you a great opportunity to save for your future. Your plan contributions are deducted from your pay before you receive the money and have a chance to spend it on other things. Tax advantages and professionally managed investment options are other valuable features of your plan. Contributing as much as possible to your plan account can help you make sure you'll have the income you'll need for a comfortable retirement.

* Social Security Administration, January 29, 2013

** *Fast Facts & Figures About Social Security, 2012,* Social Security Administration, 2013

THE ART OF LETTING GO

(Continued from page 2)

Dalbar found the average US mutual fund investor underperformed the S&P 500 by nearly 4 percentage points a year.[1]

This documented difference between simple index returns and what investors receive is often due to individual behavior—in being insufficiently diversified, in chasing returns, in making bad timing decisions, and in trying to "beat" the market.

Recently, one of Australia's most frequently quoted brokers broke ranks from the industry and gave the game away on this "busy" investing. In his final note to clients before retiring to consultancy work, Morgan Stanley strategist Gerard Minack said he had found over the years that investors were often their worst enemies.[2]

"The biggest problem appears to be that—despite all the disclaimers—retail flows assume that past performance is a good guide to future outcomes," Minack said.

"Consequently, money tends to flow to investments that have done well, rather than investments that will do well. The net result is that the actual returns to investors fall well short not just of benchmark returns, but the returns generated by professional investors. And that keeps people like me employed."

It's a frank admission and one that reinforces the ancient Chinese wisdom: "By letting it go, it all gets done. The world is won by those who let it go. But when you try and try, the world is beyond the winning."

1. "Quantitative Analysis of Investor Behavior," Dalbar, 2013.

2. Gerard Minack, "Downunder Daily," Morgan Stanley, May 16, 2013.

IT IS ALL IN HOW YOU PLAY THE GAME

The "kids" are heading back to school, the days are getting shorter, and the Summer heat will be leaving us soon. It once again is time for football. Many of you die-hard football fans have been impatiently waiting for this to happen for a while.

True investing is much like the game of football. You decide upon a goal or goals and work on a strategy to attempt to attain those goals. There will be obstacles along the way. Not all football plays end with the desired results, nor is there a gain on the field with each play, or a touchdown at the end of each series of plays. What is important is discipline and staying in the game no matter what happens and not throwing in the towel. Persistence is important both in playing football and in investing. An investment allocation is developed and tailored to fit your goals and risk tolerance level in an attempt to meet your financial goals. Many football games have been won in the final quarter of the game. Persistence pays off.

As mentioned in the "Art of Letting Go" article, a study known as the Dalbar Study ("Qualitative Analysis of Investor Behavior," Dalbar, 2013.) is done each year regarding investor behavior. Many investors exhibit bad behavior when investing and are easily influenced by the media noise that constantly bombards them. The Study shows that over a 20-year period up to 2012 the average US mutual fund investor underperformed the S&P 500 by almost 4% a year. Persistence and following the game plan was thrown out the window. An emotional rather than a disciplined academic approach was chosen.

Changes in your life that occur (e.g., different family dynamics, new financial goals, changes in health, etc.) may require some tweaking of your investment strategy much like making a few play adjustments during a football game. However, in neither instance is it a good idea to just throw in the towel the minute things are not going as originally planned.

No matter who your favorite team or teams are, we hope that you will enjoy another football season and that your investment portfolio will prosper. Let the games begin!

Our Basic Tenets

Our objective is to design portfolios using passive asset class funds that maximize investors' returns within their tolerance for risk. Here is what sets us apart:

- Fee-only investment management
- A disciplined investment strategy
- Access to institutional no-load passive asset class funds
- An academic Nobel Prize-winning investment approach
- Continued access to academic research
- A tax-efficient focus with valuable tax- and estate-planning ideas
- Risk tolerance assessment
- Periodic portfolio rebalancing
- Regular communications and state-of-the-art reporting
- No front-end loads, no back-end loads, no surrender fees, not locked in
- MOST IMPORTANT ... A TRUSTED ADVISOR RELATIONSHIP

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INTRODUCTIONS—REFERRALS ARE ALWAYS APPRECIATED.

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